

**DW 05-112
DW 05-177**

HAMPSTEAD AREA WATER COMPANY

**Investigation into Permanent Rates and
Petition for Approval of Fire District and Fire Protection Rates**

Order Approving Stipulation on Consolidated Permanent Rates

ORDER NO. 24,626

May 26, 2006

APPEARANCES: Robert C. Levine, Esq. for Hampstead Area Water Company; F. Anne Ross, Esq. of the New Hampshire Office of the Consumer Advocate on behalf of residential ratepayers; and Marcia A.B. Thunberg, Esq. for Commission Staff.

I. PROCEDURAL HISTORY

Hampstead Area Water Company (HAWC) is a regulated water utility and serves over 2,500 customers in approximately a dozen communities throughout southeastern New Hampshire. On July 1, 2005, HAWC filed a petition with the New Hampshire Public Utilities Commission (Commission) for an increase in permanent rates for its current franchises and a single consolidated rate for those franchises. A more complete description of the rate relief sought and procedural history can be found in Order No. 24,556 (December 2, 2005), wherein the Commission approved temporary rates for HAWC. The Commission designated Docket No. DW 05-112 as to the consolidated rate proceeding.

On November 1, 2005, HAWC filed a petition for approval of a fire protection district and rates in the Town of Atkinson, which was designated Docket No. DW 05-177. In that petition, HAWC requested authority to provide fire protection service within its Atkinson franchise territory with an annual base charge of \$1,925.00 and an annual maintenance charge of \$160.00 per hydrant. According to the petition, these charges reflect the current contract terms

between the Town of Atkinson and HAWC, dated April 20, 1994. On December 27, 2005, Staff submitted a letter to the Commission indicating that Staff, the Office of Consumer Advocate (OCA) and HAWC had agreed to resolve the issues relative to the proposed Atkinson fire protection rates within the context of the general rate proceeding in Docket No. DW 05-112.

On April 18, 2006, pursuant to the procedural schedule, Staff filed a Stipulation Agreement on behalf of itself, HAWC, and OCA. On May 2, 2006, the Commission held a duly noticed hearing and received evidence and testimony in support of the Stipulation Agreement.

On May 9, 2006, HAWC submitted its accounting of the temporary rate recoupment allowed under RSA 378:29 as well as its accounting of rate case expenses. HAWC supplied supporting documentation and proposed refunds and surcharges relating to recovering the rates and expenses.

On May 19, 2006, Staff filed a letter recommending the Commission approve HAWC's proposed refunds and surcharges, with some modification. Staff reviewed HAWC's calculation of the net recovery for temporary rates, \$13,551, and agreed with HAWC's proposed surcharge.¹ Staff also reviewed HAWC's proposed rate case expenses and recommended a total of \$1,417.76 be eliminated from recovery. Staff concluded that \$1,170.10 pertained to the Commission's audit of HAWC, noting that the Commission has customarily excluded such costs from rate case expense recovery. Staff also stated it identified two billing errors totaling \$247.66, recommending that this amount also be removed from recoverable expenses. Accordingly, Staff recommended the Commission approve recovery of \$29,992.21 in rate case expenses.

¹ HAWC's Proposed (refund)/surcharge per customer was, by system: Bricketts Mill (\$22.21); Colby Pond (\$3.21); Kent Farm \$26.88; Oak Hill \$0.60; Rainbow Ridge \$18.67; Stoneford (\$2.15); Lancaster Farm \$22.39; Walnut Ridge \$7.91; Hampstead Core (\$0.93); Camelot Court (\$20.68); Cornerstone (\$9.57); Cricket Hill / Maplevale (\$3.41); Lamplighter \$3.57; Mill Woods \$0.00; Waterford Village \$0.00; and Autumn Hills \$0.00.

Staff also recommended the Commission calculate the surcharge based upon recovery from 2,741 customers, i.e., its present actual number of customers, as opposed to the *pro forma* number used for settlement purposes of 2,955. Staff concluded that, since it is not known whether HAWC will actually reach 2,955 customers during the recovery period, it would be inequitable to assume that number of customers and thus expose HAWC to significant risk of not recovering the full amount.

Regarding the recovery period, HAWC proposed using two billing quarters for customers owing more than \$10.00 and one billing quarter for those customers owing \$10.00 or less. Staff disagreed with this approach on the grounds that it would be unnecessarily complicated and would result in excessive charges for the customers of certain systems, especially those served by Kent Farm, Rainbow Ridge, and Lancaster Farms. Staff, instead, recommended the Commission extend the recovery to four billing quarters for all customers.²

II. STIPULATION AGREEMENT

Staff, OCA, and HAWC's positions are set forth in the Stipulation Agreement, which is summarized below.

A. REVENUE REQUIREMENT

Staff, OCA, and HAWC agreed to an overall consolidated revenue requirement of \$1,126,148. This revenue requirement consists of: (1) a permanent rate component of \$1,110,892, which was established based upon the rate base, operating revenue and operating expenses, as adjusted for the test year 2004, and which include plant investment and operation and maintenance expenses relating to the Granite Village – Phase V system in Docket No. DW

² Staff Recommended Quarterly (Refund)/Surcharge per Customer: Bricketts Mill (\$2.82); Colby Pond \$1.93; Kent Farm \$9.46; Oak Hill \$2.89; Rainbow Ridge \$7.40; Stoneford \$2.20; Lancaster Farm \$8.33; Walnut Ridge \$4.71; Hampstead Core \$2.50; Camelot Court (\$2.43); Cornerstone \$0.34; Cricket Hill / Maplevale \$1.88; Lamplighter \$3.63; Mill Woods \$2.74; Waterford Village \$2.74; Autumn Hills \$2.74.

05-154; and (2) a step increase component in the amount of \$15,256, which was established based upon the recent installation of certain arsenic treatment facilities.

B. CONSOLIDATED CUSTOMER RATE

Staff, OCA, and HAWC agreed that a system-wide consolidated rate based upon the agreed upon revenue requirement is just and reasonable. That rate consists of a base charge of \$25.00 per quarter and a consumption charge of \$3.09 per 100 cubic feet. Inclusive of the proposed \$.06 step adjustment, the volumetric portion of that rate changes to \$3.15 per 100 cubic feet. Staff, OCA, and HAWC agreed that the reconciliation of temporary and permanent rates pursuant to RSA 378:29 should not include the step adjustment discussed below.

C. ARSENIC TREATMENT FACILITIES

Staff, OCA, and HAWC recommended the Commission grant HAWC a step increase for recently installed arsenic treatment facilities. The treatment facilities were installed to meet federal Environmental Protection Agency arsenic requirements. Staff, OCA, and HAWC agreed that such treatment facilities are fully used and useful and are in service to customers and recommend the Commission approve an additional revenue requirement of \$15,256 to account for this addition to rate base and addition to annual operating expenses.

D. STEP ADJUSTMENT FOR LOCAL PROPERTY TAXES NOT YET ASSESSED

Staff, OCA, and HAWC recommended the Commission authorize HAWC to petition the Commission, no later than March 31, 2008, for an additional step adjustment for local property taxes that have yet to be assessed and which are imposed as of January 1, 2008. Staff, OCA, and HAWC agreed that contributed plant being added to HAWC's books as a result of the plant inventory undertaken pursuant to DW 02-128 may increase HAWC's local property tax liability. The Stipulation includes an explicit agreement among the signatories that recovery of this

property tax liability through rates is appropriate. HAWC agreed that any petition seeking such recovery shall include supporting documentation and copies of all pertinent local property tax bills as well as a proposal for a step adjustment in rates for Staff and OCA's review and recommendations.

E. RECONCILIATION AND TEMPORARY RATES

Staff, OCA, and HAWC agreed that HAWC shall reconcile the permanent rate component of the consolidated rate with the temporary rates charged from November 30, 2005 forward and that HAWC will submit a proposal for a temporary rate recoupment for Staff and OCA's review and recommendations. Staff, OCA, and HAWC agreed that any recoupment of temporary rates should be combined with recovery of rate case expenses so that a single customer surcharge results.

F. RATE CASE EXPENSES

HAWC agreed to submit documentation of its rate case expenses, proposed surcharge for those expenses, and temporary rate recoupment to Staff and OCA for their review and recommendations. As described above, this filing has already occurred.

G. FIRE PROTECTION DISTRICT

Staff, OCA, and HAWC agreed that it is appropriate for HAWC to operate a fire protection district in Atkinson. Staff, OCA, and HAWC agreed that the fire protection rate, comprised of a \$1,925.00 annual base charge and an annual maintenance charge of \$160.00 per hydrant, as was agreed to in a contract between the Town of Atkinson and HAWC, is just and reasonable.

H. REPORTING REQUIREMENTS

HAWC agreed to continue to establish and maintain separate continuing property records (CPR's) for each of its individual water systems. Staff, OCA, and HAWC recommend HAWC no longer be required to maintain separate revenue and expense records for each individual system.

HAWC agreed to submit quarterly financial reports to the Commission that are consistent with the Commission's chart of accounts for water utilities. HAWC agreed to include in each such report an income statement, a balance sheet and a detailed report of long-term debt listing all current outstanding amounts along with current interest rates.

HAWC agrees to continue to update its CPR's for certain systems still under construction: Autumn Hills, Granite Village – Phase V, Jameson Ridge, Angle Pond and Waterford Village. For the purposes of calculating the initial rate, the costs of fixed plant and Contributions in Aid of Construction (CIAC) were estimated as were certain associated operating expenses such as depreciation, amortization of CIAC and property taxes. For this reason, according to the signatories, the actual construction costs may differ from the estimates used to calculate the initial rate contemplated in the Stipulation. HAWC agreed to make available for Commission review the CPR's for these systems within sixty (60) days of the final completion of construction. If the actual construction costs differ more than 10%, then Staff, OCA, or HAWC would have the option of petitioning the Commission to amend the rate contemplated in the Stipulation based upon the actual costs of construction for these systems.

In conjunction with the filing of its Annual Report with the Commission, HAWC agreed to submit an annual reporting to the Commission of water produced and consumed, by system.

III. COMMISSION ANALYSIS

RSA 378:7 authorizes the Commission to establish just and reasonable rates for a utility after conducting a hearing. In determining just and reasonable rates, the Commission must balance the consumers' interest in paying rates no higher rates than are required with the investors' interest in obtaining a reasonable return on investment. *Eastman Sewer Co.*, 138 N.H. 221, 225 (1994). In circumstances where a utility seeks to increase rates, the utility bears the burden of proving the necessity of the increase pursuant to RSA 378:8.

We first consider the revenue requirement proposed by Staff and the parties. Staff and the parties propose an overall consolidated revenue requirement of \$1,126,148. This revenue requirement is inclusive of a step increase of \$15,256, which we will discuss later. As summarized in Exhibit A to the stipulation, the revenue requirement represents a settlement between Staff, OCA, and HAWC of all issues related to the revenue requirement, including allowed overall rate of return, return on equity, *pro forma* adjustments, capital additions to rate base, operating expenses, depreciation issues, and temporary rates. Staff and the parties represent that the revenue requirement is based on investments prudently incurred and used and useful in the provision of utility service. After reviewing the record and testimony at hearing, we agree with Staff and the parties and find the resulting revenue requirement is just and reasonable, approving it on that basis.

The increase in HAWC's revenue requirement amounts to of 80.73 percent increase over HAWC's 2004 test year revenues. Although the percentage rate increase is larger than comparable increases recently approved for other utilities, we find this increase reasonable because, among other things, HAWC has not had a rate increase since the 1980s and there has

been upward pressure on rates from a variety of sources, including requirements of the Safe Drinking Water Act, in that period. HAWC has been operating under a variety of tariffs for the systems within the Hampstead Core, Walnut Ridge, and its various other satellite systems for many years. The rate for the Hampstead Core has been the same since January 20, 1988. The rate for Walnut Ridge has been the same since February 23, 1987. In most other cases there has not been a request for rate increase since the inception of the various satellite systems in the mid 1980s. HAWC attempted to seek rate relief in 2002 in Docket No. DW 02-128. That docket, however, developed into an investigation into recordkeeping issues and other compliance matters; no rate changes were authorized. The Commission has long recognized the principles of gradualism and avoidance of rate shock, and now that HAWC has met its obligations arising out of Docket No. DW 02-128, we urge HAWC to seek rate changes on a more timely basis, so as to be consistent with these principles.

We understand HAWC seeks to add to its rate base certain capital improvements relating to arsenic treatment facilities installed subsequent to the test year in this docket. Staff and the parties recommend that the revenue requirement be increased by \$15,256 to account for additions to rate base and additional annual operating expenses and that the associated increase in rates of \$.06 be effective as of the date the Commission approves permanent rates as a step adjustment. Step adjustments to rates are employed as a means of ensuring that a regulated utility retains its ability to earn a reasonable rate of return even after implementing large capital projects. Its purpose is to avoid placing a utility in an earnings deficiency immediately after a rate case in which a revenue requirement was based on a historical test year, which in this case was 2004. We understand EPA's arsenic standards were recently made more stringent and water utilities have had to make capital improvements to comply. Hearing Transcript of May 2, 2006

(5/2/06 Tr.) at 28 lines 10-24. We accept Staff and the parties' assertions that the capital improvements are presently used and useful and are in service to customers. We further find that it is reasonable to include them in rate base since traditional rate-of-return principles permit a utility to have "the opportunity to make a profit on its investment, in an amount equal to its rate base multiplied by a specified rate of return." *Appeal of Conservation Law Foundation*, 127 N.H. 606, 634 (1986). Accordingly, we find it just and reasonable to approve the proposed \$.06 step increase, effective as of the date of this order on a service rendered basis, to cover costs associated with the arsenic treatment facilities. We also find reasonable the recommendation that the arsenic treatment facility not be considered part of permanent rates subject to reconciliation pursuant to RSA 378:29.

We next consider Staff and the parties' recommendation to consolidate HAWC's rate groups. A decision on consolidation of rates is a policy decision that is subject to the statutory requirements that rates be just and reasonable and that we act in the public interest. See RSA 374:2 and RSA 378:28. We have considered the issue of single tariff pricing for water utilities in the past. See, *Pennichuck Water Works, Inc.*, 83 NH PUC 197 (1998); *Lakes Region Water Co.*, 84 NH PUC 125 (1999).

In the instant case, as noted in Exhibit A to the Stipulation, ten of the systems would see a decrease in rates as a result of consolidation and six would see an increase. If stand-alone rates were in effect, the annual estimated rates based on per-system consumption data would range from \$571 to \$274. With consolidated rates, the annual estimated rates, based on the consumption data available for each system, will range from \$515 to \$329. In the 1999 *Lakes Region* decision, the Commission observed that "an overriding consideration that favors rate consolidation is the wide disparity in rates among customers of the individual systems that would

result from denying [the] request.” *Lakes Region*, 84 NH PUC at 128. In the instant case, eliminating disparities among the individual systems is likewise consistent with the long-term best interests of the utility’s customers. In the case of water utilities with multiple individual systems, consolidation will help insulate those individual systems from future rate shock when significant investments are made to comply with environmental mandates or for other reasons. This protection helps ensure that each system can continue to provide safe and adequate water service pursuant to RSA 374:1. Additionally, as Staff has noted, the consolidated rate is likely to produce administrative efficiencies for HAWC that can reduce administrative costs borne by customers.

Although it might be argued that rate consolidation constitutes a departure from traditional, cost-of-service ratemaking because of the potential for cross-subsidization between individual systems, in another sense such an approach is consistent with the cost-of-service approach. This is because cost-of-service ratemaking always involves at least some degree of cost-averaging because the cost of serving any given customer is never identical to the cost of serving another. For these reasons, we find that consolidating HAWC’s multiple rate groups into one consolidated tariff is just and reasonable.

The stipulation contemplates that HAWC will seek a second step adjustment for local property taxes which Staff and the parties believe may be assessed against HAWC within the next year and a half in light of certain significant increases in the utility’s book value. The settlement characterizes the recovery of such taxes through rates as “appropriate,” which we understand to be an agreement that consideration of such a step adjustment by the Commission would be limited to the amount of the adjustment as distinct from its propriety.

As noted above, step adjustments are typically appropriate to those situations in which a utility implements large capital projects that would create an earnings deficiency absent a rate adjustment. Although new property taxes is a somewhat different situation, the potential impact on earnings is likewise significant in this instance. We agree with Staff and the parties that, given HAWC's lack of rate relief in recent years, the need to moderate rates may necessitate HAWC filing for a step increase for local property taxes. We find that this provision of the stipulation, seeking a determination that recovery of such taxes through a step adjustment is appropriate if sought by HAWC by March 31, 2008, is consistent with the public interest.

We now address the recoupment of the permanent rate increase, effective date, rate case expenses, and recovery period of surcharges. RSA 378:29 requires that, at the conclusion of the rate proceeding, the utility be allowed to amortize and recover the difference between the temporary rate and permanent rate for the period of time that temporary rates were in effect. In Order No. 24,556 (December 2, 2005), the Commission authorized HAWC to raise rates by 34.49 percent, effective for service rendered on or after November 30, 2005, on a temporary basis. In anticipation of approval of permanent rates, HAWC filed its accounting of the temporary rate recoupment allowed under RSA 378:29. Staff has reviewed HAWC's calculation of the net recovery for temporary rates and agrees HAWC is entitled to recover an additional \$13,551. Accordingly, we find that HAWC is entitled to recover that amount from customers.

With respect to rate case expenses, Staff recommended the Commission disallow \$1,170.10 attributable to the Commission's audit of HAWC, disallow two billing errors totaling \$247.66, and approve for recovery a total of \$29,992.21 in rate case expenses. We agree that expenses associated with the Commission's audit of HAWC's records should be excluded from the rate case expense surcharge. The Commission has a long standing practice of not authorizing

the recovery of audit-related costs through a rate surcharge designed to cover the expenses of prosecuting a rate case. Response to audit requests is a continuing obligation of utilities under RSA 374:18 and is therefore recognized in calculating the permanent rate in RSA 378:28.

Allowing expenses associated with responding to audit requests as a surcharge for rate case expenses would in effect amount to double recovery of these expenses. As to the billing errors discovered by Staff, we will also deny recovery of those expenses. Thus, we will approve HAWC's recovery of \$29,992.21 in rate case expenses.

Staff's recommendation also modified the number of customers HAWC should use to calculate the respective recovery surcharges. Staff explained that HAWC's present customer count is 2,741 and that the number used for settlement purposes, 2,955, was a *pro forma* number meant to capture expected growth. We agree with Staff that it is more appropriate to use the actual customer number rather than the *pro forma* customer count since using the latter may result in HAWC not fully recovering its approved rates and rate case expenses. With respect to HAWC's proposal to use two billing quarters for customers owing more than \$10.00 and one billing quarter for those customers owing \$10.00 or less, we agree that this method of recovery is unnecessarily complicated and may result in excessive charges for the customers in Kent Farm, Rainbow Ridge, and Lancaster Farms. Accordingly, we will approve HAWC's recovery over four billing quarters.

The stipulation includes resolution of another docket, DW 05-177, relating to HAWC's provision of fire protection service to the Town of Atkinson pursuant to an agreement executed between Walnut Ridge Water Company, a predecessor of HAWC, and the Town of Atkinson, dated April 20, 1994. Staff and the parties recommended the Commission consider this agreement in Docket No. DW 05-112 since revenues derived from this agreement would be

considered in the context of this rate case.³ Given the age of the agreement, this filing appears to be a compliance filing to rectify a previously unapproved rate. We customarily encourage Staff and the parties to fully consider all revenues and expenses in the context of a rate investigation and this docket is no exception. Staff and the parties reviewed this agreement and we note that Exhibit A to the stipulation adjusts HAWC's revenue requirement downward by \$11,045 to account for these revenues. We agree that it is appropriate to recognize these revenues in this docket and we find the proposed fire protection rates are just and reasonable. Accordingly, we will approve the agreement between HAWC and the Town of Atkinson.

Lastly, we note the stipulation requires ongoing reports from HAWC. At hearing, Staff testified that Staff and the parties believed that HAWC had grown in size sufficient to warrant quarterly reporting of its finances. 5/2/06 Tr. at 40 lines 21-24. Staff expressed its interest in monitoring HAWC's finances to keep informed about HAWC's debt position and OCA expressed its concern over HAWC's debt-to-equity ratio. These reports appear to facilitate monitoring of HAWC and we deem them reasonable requirements. As to the requirement that HAWC provide continuing property records (CPRs) for the Autumn Hills, Granite Village, Jameson Ridge, Angle Pond, and Waterford Village systems, we understand that these systems are presently under construction and accurate CPR's were unavailable for the rate case. HAWC's agreement to provide documentation of plant costs and Contributions in Aid of Construction (CIAC) to corroborate estimates used in this rate case are reasonable safeguards to customers that the proposed rates are soundly based. We approve the requirement that HAWC supply CPR's within sixty (60) days of the final completion of construction of these systems.

³ In a letter dated December 27, 2005, Staff informed the Commission of Staff and the parties' intent to ask the Commission take up the issues raised in DW 05-177 during the rate proceeding.

The stipulation also contains a requirement that HAWC provide a report of lost water. Staff and the parties correctly note that we have previously required all regulated water utilities to submit an annual accounting of lost water, tabulated monthly, with their annual reports. In HAWC's situation, however, monthly tabulation of data is not feasible since customer meters are read quarterly, not monthly. 5/2/06 Tr. at 43 lines 16-21. Staff and the parties requested the Commission partially waive the lost water reporting requirement and allow HAWC to submit annual production and consumption data, by system, with its annual report. Since we have previously found HAWC's proposed permanent rates to be just and reasonable and they are billed quarterly, we find it reasonable and consistent to grant the waiver request. Accordingly, we waive the requirement of lost water reporting with monthly tabulation until such time as HAWC can provide monthly meter reading for its customers.

Having reviewed the record in this proceeding, including the stipulation and supporting testimony presented at the May 2, 2006 hearing, we find the terms of the stipulation to be reasonable and for the public good. We find that the terms will result in just and reasonable rates and represent an appropriate balancing of ratepayer interests and the interests of HAWC's investors under current economic circumstances. Accordingly, we approve the stipulation.

Based upon the foregoing, it is hereby

ORDERED, that the stipulation entered into among the parties to this proceeding and Commission Staff is approved as discussed herein; and it is

FURTHER ORDERED, that the consolidated permanent increase in rates for Hampstead Area Water Company is hereby approved for service rendered on or after the effective date of this order; and it is

FURTHER ORDERED, that Hampstead Area Water Company, is authorized to recover \$13,551 pursuant to RSA 378:29 in a surcharge to customer bills over four (4) billing quarters as specified above; and it is

FURTHER ORDERED, that Hampstead Area Water Company is authorized to recover \$29,992.21 in rate case expenses in a surcharge to customer bills over four (4) billing quarters as specified above; and it is

FURTHER ORDERED, that Hampstead Area Water Company, include in its annual report an annual accounting of lost water and the requirement that such data be tabulated monthly is hereby waived as discussed herein; and it is

FURTHER ORDERED, that Hampstead Area Water Company file a compliance tariff within ten days of the date of this order.

By order of the Public Utilities Commission of New Hampshire this twenty-sixth day of May, 2006.

Thomas B. Getz
Chairman

Graham J. Morrison
Commissioner

Clifton C. Below
Commissioner

Attested by:

Debra A. Howland
Executive Director & Secretary